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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-1159

THE ANDERSON COMPANY and ALICE SCRANTON EASTMAN ANDERSON,

Petitioners,

against

JOHN P. CHASE, INC.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners, The Anderson Company and Alice Scranton Eastman Anderson, respectfully pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this action on November 18, 1975.

Opinions Below

The United States District Court for the Southern District of New York rendered two opinions herein. The first, dated March 12, 1975, dismissed the complaint herein and is not officially reported. It appears at [1974-75 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 95,009. The second, dated June 2, 1975, denied a post trial motion and

is not officially reported. Both opinions are reproduced in the appendix herein. The order of the Court of Appeals for the Second Circuit, affirming the District Court's order, is also reproduced in the appendix.

Jurisdiction

The Judgment of the United States Court of Appeals for the Second Circuit was entered on November 18, 1975. This petition for certiorari was filed within ninety days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

Questions Presented

1. Is a private right of action for damages maintainable under the Investment Advisers Act?

2. (a) Is the Decision below, holding that a written contract of a registered investment adviser may be orally amended, contrary to the provisions of the Investment Advisers Act of 1940 and destructive of the proper enforcement of its anti-fraud provisions?

(b) Are misrepresentations as to whether "investment supervisory services" are being performed actionable under the Investment Advisers Act?

(c) Is failure to perform contracted-for "investment supervisory services" actionable under the Investment Advisers Act?

Statutes and Rule Involved

Sections 201, 202(a)(13), 204, 206, 206A, 208(c), 214 and 215 of the Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-1, 80b-2(a)(13), 80b-4, 80b-6, 80b-6(a), 80b-14,

80b-15 and Rule 204-2(a)(3),(7), and (10) thereunder, 17 C.F.R. § 275.204-2(a)(3),(7), and (10) are set forth in the appendix hereto.

Statement of the Case

A. Introduction and Summary of Argument

Petitioners herein, plaintiffs below, contracted in writing and paid for "investment supervisory services" to have been furnished by respondent, John P. Chase, Inc. ("Chase, Inc.")*, defendant below and an "investment counselor," registered as an adviser under the Investment Advisers Act of 1940, 15 U.S.C. § 80b (the "Act"). Such services are expressly defined in the Act, which imposes the fiduciary duty of continuous supervision of accounts and the submission of investment counsel tailored to the specific needs, problems and obligations of clients. During the four-year term of the counseling contract, respondent initially submitted the required recommendations from time to time. Later, without the knowledge or the consent of petitioners, respondent unilaterally ceased supervising the accounts and under changing conditions failed to keep adequate records of material information necessary in order to provide professional investment counseling as represented.

The result was predictable: in petitioners' accounts "supervised" by Chase, Inc. huge losses were sustained.

In Point I below, we urge this Court to follow a line of District Court authority developed in the Second Circuit (and to overrule the Court of Appeals for the Eighth Circuit and District Court cases decided in the Fifth and Ninth Circuits) and to hold that a person thus misled by his investment adviser has a right of action for damages.

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* On January 14, 1976 respondent changed its name to "Phoenix Investment Counsel of Boston, Inc.".

As shown below in Point II, respondent repeatedly misrepresented the services it provided in violation of the Investment Advisers Act, and in violation of its fiduciary duty. We urge this Court to settle an important question of law regarding enforcement of the Act and thereby to achieve a significant measure of protection for investors: to hold that investment counsel must honor their written contracts, and may not unilaterally alter them, or claim later oral amendments.

B. Statement of Facts

Petitioner Alice S. E. Anderson is 69 years old. Her business affairs were arranged by her son, Douglas Anderson. Petitioner The Anderson Company ("Anderson Company"), is a Massachusetts limited partnership, the partners of which were Douglas Anderson, his mother and his wife. Anderson Company, previously an engineering and manufacturing concern, founded and managed by Mrs. Anderson's late husband, subsequently had as its sole business the holding and investment of Anderson family real and personal property (Tr. 18; 18a-19a).*

In September 1966, Douglas Anderson called upon John P. Chase, the founder and senior officer of respondent, Chase, Inc., to discuss obtaining investment counseling services. At that meeting, Chase told Anderson that Chase, Inc. would not counsel accounts containing less than $500,000. To meet this requirement, it was agreed between them that the accounts of petitioner Mrs. Anderson, petitioner Anderson Company, and the family testamentary

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* References to the trial transcript not included in the appendix on appeal to the Court of Appeals are designated "Tr." followed by page numbers. References to the appendix on appeal to the Court of Appeals are to the page number in the appendix, followed by "a", e.g., "18a". "Dft. Exh." refers to the defendant's exhibits below. "Pltf. Exh." refers to plaintiffs' exhibits below. Depositions are designated by witness name, "dep." and page number.

trust would be treated as one entity. However, even this pooling of the accounts would bring the total amount to be under supervision only to approximately $260,000. Accordingly, Mr. Anderson informed Chase that he would be willing to borrow against the family property in order to raise an additional $225,000 to bring the account to a size sufficient to be managed by Chase, Inc. (179a-186a; 28a; 387a-420a).

Thereafter, as of November 1, 1966, Douglas Anderson on behalf of the three accounts executed a contract with Chase, Inc. to obtain "investment supervisory services." (385a) Chase represented that it offered no less than supervisory services to any of its clients, and had so informed the Securities and Exchange Commission in its registration form ADV. (486a) These services were described in part in Chase, Inc.'s brochure, provided to Anderson, as follows:

"NATURE OF OPERATIONS

"John P. Chase, Inc. is an internationally known Boston based investment counsel firm. It was incorporated in 1932 under Massachusetts law to carry on the business of *investment counsel* and as such to advise persons, firms and corporations with respect to investments and to do all things which are necessary or incidental to the conduct of the business of investment counsel.

"Recognizing the professional nature of our operations, we do no advertising. Our relationship with our clients is entirely confidential and we limit our activities to the rendering of investment advice. *It is our policy to restrict our operations to the management of a relatively few large accounts in the belief that clients are served best by rendering service of a highly personal nature tailored to their individual investment needs and objectives.*

* * *

> *"In the management of investment accounts we maintain complete flexibility. Each account is counseled according to its individual needs, objectives and restrictions.* As shifts occur in the balance of economic factors, we make corresponding adjustments in clients' portfolios, both among individual holdings, emphasis on industries and in the balance between common stocks and bonds. When the preponderance of factors is favorable, equity holdings are increased and, conversely, when our analysis indicates an unfavorable outlook, the common stock interest is reduced accordingly with a corresponding increase in bonds or short-term securities to establish common stock buying reserves." (368a; 372a) (Emphasis supplied.)

The investment counsel contract mailed by Chase to Anderson was substantially identical to the specimen form made a part of Chase's registration form ADV on file with the Securities and Exchange Commission. It provided that Chase would act as

> ". . . investment managers to analyze and supervise the investment accounts of (Mrs.) Alice S. E. Anderson, The Anderson Company and to advise [the petitioners] concerning any changes in the investments which [Chase, Inc.] may consider expedient with reference to the state of these accounts and to market conditions." (385a; 487a)

This contract concludes by stating:

> *"This arrangement,* although mutually revocable at any time, *is to continue in effect until written notice to the contrary is given by either of us,* and no assignment of this contract can be made without [petitioners'] consent." (Emphasis supplied.)

Throughout the entire contract period Chase, Inc.'s invoices described Chase, Inc.'s services rendered as that of

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"investment counsel." (Tr. 436) This is a term of art meaning no less than continuous personalized supervision based upon a detailed understanding of the needs, obligations and objectives of the client.*

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* At the commencement of the events described in this petition, Chase, Inc. belonged to the Investment Counsel Association of America, Inc., a professional society with stringent standards of conduct. However, Chase, Inc. resigned from the Association midway through the contract term, and did not so inform petitioners. Publications of the Association describe "investment counsel" as follows:

> "Investment counseling carries within its makeup the fundamentals that make it professional:
>
> √ zeal and aptitude in comprehending the investing needs and objectives of its clients . . .
>
> √ initiative in portfolio planning and in building the estates of clients . . .
>
> √ investment philosophy compatible with a client's objectives and complete dedication to his interests.
>
> • • •
>
> "The counselor or his organization is not employed merely to advise what and when to buy and sell. He accepts responsibility for participation in planning and managing the client's financial future. How? In concert with the client, with knowledge of sources of money, income needs, funds available now or in prospect, investment philosophies and personal propensities.
>
> • • •
>
> "Investment counseling requires initiative. The counselor and his organization have many industries and hundreds of companies under constant appraisal. This appraisal is the basis for continuous and personalized attention to each client's particular objectives. When conditions appear favorable for buying or selling, the client gets appropriate recommendations.
>
> • • •
>
> The basic purpose of Professional Investment Counsel is to plan and carry forward a portfolio to meet the needs and desires of the client. There are also other important benefits which investment counsel may provide:
>
> √ To relieve the client of activities which he may not be fully equipped to assume . . .
>
> √ To take the initiative in recommending action in line with the approved objectives . . ."

("This is Investment Counsel," Investment Counsel Association of America, 1967.)

The Act provides:

> "It shall be unlawful for any person registered under § 80b-3 of this title to represent that he is an investment counsel or to use the name "investment counsel" as descriptive of his business unless (1) his or its principal business consists of acting as investment adviser, and (2) a substantial part of his or its business consists of rendering investment supervisory services." (Act, § 208(c), 15 U.S.C., § 80b-8(c)).

"Investment supervisory services" are defined as:

> ". . . the giving of continuous advice as to the investment of funds on the basis of the individual needs of each client." (Act, § 202(a)(13), 15 U.S.C., § 80b-2 (a)(13)).

A description of the minimum amount of information which an investment counselor *must* have about his client is contained in the SEC's form ADV, filed by respondent with the SEC. Question 18(a) reads:

> "Does Applicant or Registrant:
>
> Furnish 'Investment supervisory services' defined as the giving of continuous advice to clients as to the investment of funds on the basis of individual needs of each client (distinguish from continuous advice of any nature which is not based on consideration of all relevant factors; e.g., the nature and amount of other assets, investments and insurance, and the nature and extent of the personal and family obligations of each client)?"

Respondent answered "Yes." Question 18(b) reads:

> "Does Applicant or Registrant:
>
> Manage securities accounts for clients under circumstances not involving 'Investment supervisory services'?"

Respondent answered "No." (486a).

According to the fact findings of the District Court, Chase, Inc. rendered investment supervisory services until December of 1968. At this time, however, according to the Court, the Chase, Inc. account manager, Henderson Inches, Jr., and Anderson mutually and *orally* agreed (despite the contract's ban on oral modification of its terms) upon far less extensive investment advisory services than those represented by the full panoply of "investment supervisory services" called for by the contract. (619a-620a)

This finding was based upon the testimony of Inches, that in a conversation in 1968, Anderson consented to accept services consisting only of a "flow of information" from Inches, rather than specific purchase or sale recommendations. (321a) This testimony was in contradiction of Inches' deposition testimony in which Inches acknowledged that he knew Anderson was relying on Chase, Inc. to provide "investment counseling." (Inches dep. pp. 327-8). Nor was there any written evidence of the alleged conversational waiver. The continuing securities trading authorizations covering petitioners' accounts, as requested by John P. Chase, signed in January of 1967 by Anderson and by his mother for the respective accounts, and running to Chase as their agent and attorney-in-fact in order to protect the accounts, were never revoked by nor returned to their makers. (Inches dep. 307, 311, 314)

According to the District Court, Chase, Inc. was willing to give Anderson the benefit of its advice as to the attractiveness of particular stocks, however, "it was not willing during this period to make recommendations involving any certain number of shares or any certain amount of money . . . ." (611a-612a) From about this time, Chase, Inc. failed to keep current records of cash in the accounts available for investment, the tax bases of property and securities held, the extent of debt and other obligations, or what advice had been given. (290a-291a; 275a; 296a) Anderson was not notified of these failures and no consent was given to this drastic internal change affecting the contractual

relationship.* (216a) Instead, statements rendered to Anderson continued at a higher scheduled fee** and persisted in describing the services as "investment counsel." (Pltf.'s Exh. 72; Tr. 436)

As a result of Chase, Inc.'s unilateral decision to cease supervising the accounts, no attempts were made to keep correct records of the accounts. Internal memoranda of orders or advice were not made (as required by Rule 204-2 (a)(3) under the Act, 17 C.F.R. § 275.204-2(a)(3)), and internal records of the accounts' cash available for investment were adjusted to zero balance. This apparently was due to an effort by Chase, Inc. personnel to relieve themselves of the obligations to supervise these funds. For an extended period, from August, 1970, until the termination of the contract, the accounts contained nearly 90% cash holdings despite the fact that Chase, Inc. was counselling other accounts to become 100% invested in equity securities. (469a-505a; Dft.'s Exh. 45)

Finally, in November, 1970, Chase wrote a letter to Anderson advising that he "cover" certain short positions undertaken by Anderson in order to hedge his family's investment against risk of market fluctuations. In order to "cover" these positions, Anderson would have been required to purchase in the market stocks which were not on the Chase, Inc. recommended list as suitable investments. (474a; 476a; 482a; 252a-262a)

Although petitioners relied upon Chase, Inc. to furnish continuous supervision in the counselling services for which they were paying, testimony by Chase, Inc. personnel showed a callous disregard for petitioners' inter-

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* In contrast, Chase, Inc. did seek written consent in March of 1969, according to requirements of the contract, for assignment of the contract to a successor corporation with the same name (453a-454a).

** In June, 1968, Anderson was notified that the fee had been raised the preceding February by 150% (32a).

ests and problems.

Q. With respect to the short sale against the box, what is it you expected Mr. Anderson to do, if he followed your letter?

A. He had a choice whether he bought it in or whether he delivered the stock that he had in the box.

Q. Did you mean by your letter to suggest which of the two alternatives was appropriate for him at that time?

A. No.

Q. When I say "him," I mean for the Anderson Company account.

A. No. He got the acccount in that shape and I was telling him to get it out. *He didn't ask me how to get there and I didn't see why I should tell him which was the better way for him to extract himself from that situation.* (Testimony of John P. Chase, 253a. Emphasis supplied.)

• • •

Q. As of October 4, 1968, this cash balance record shows the Anderson Company account to be short $84,000.00 and some change, is that correct?

A. That's correct.

Q. And the next entry on that cash balance sheet is an $84,000.00 entry in the exact same amount as the short amount, equalizing the two amounts, is that correct?

A. It is the same amount as the amount that was overdrawn on our cash balance, yes, sir.

Q. What caused the influx of that cash?

A. That was done to bring the cash balance to zero, for appraisal purposes.

Q. That was a bookkeeping entry?

A. Yes, sir.

Q. Then when you started out on the next period, commencing in October of 1968, you begin with a zero cash balance again?

A. We maintain the zero cash balance, yes.

Q. Did you inquire of Mr. Anderson whether they were able to come up with the $84,000.00 and change that they were short?

A. *That was Mr. Anderson's problem.*

Q. Did you know when you commenced counseling in the October 1968 period whether or not you should recommend sales to generate $84,000.00 or whether there was more cash available so that you should recommend purchases? Did you know that?

A. If Mr. Anderson told me that, yes, but he did not.

Q. Did you inquire of him?

A. I did not .

(Testimony of Richard Spindler, 290a-291a. Emphasis supplied.)

In February, 1971, Anderson terminated the investment counseling relationship in accordance with the contract's terms. (483a)

C. Basis for Jurisdiction Below

The complaint herein, filed on June 8, 1973, asserted jurisdiction under the Investment Advisers Act of 1940, 54 Stat. 847, 15 U.S.C. § 80b-1 *et seq.*, and principles of pendent jurisdiction.

REASONS FOR GRANTING THE WRIT

I. A conflict exists between lower federal courts on the question of whether or not a private right of action for damages may be maintained under the Investment Advisers Act.

This Court should grant certiorari to settle an important point of law as to which lower federal courts are divided. District Courts in the Second Circuit have held that a private right of action may be maintained under the Act. *Abrahamson* v. *Fleschner,* 392 F. Supp. 740 (S.D.N.Y. 1975);

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Bolger v. *Laventhol, Krekstein, Horwath & Horwath,* 381 F.Supp. 260 (S.D.N.Y., 1974). See also *Angelakis* v. *Churchill Management Corp.,* [Current Vol.] CCH Fed. Sec. L. Rep. ¶ 95,285 (N.D. Cal. 1975). However, the contrary conclusion was reached by District Courts in the Fifth and Ninth Circuits. *Gammage* v. *Robert, Scott & Co., Inc.,* [1973-74 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 94,761 (S.D. Cal. 1974); *Greenspan* v. *Eugene Campos Del Toro,* 73-638 Civ. (S.D. Fla., May 17, 1974) (unreported).

In 1961, the Court of Appeals for the Eighth Circuit held in *Brouk* v. *Managed Funds, Inc.,* 286 F.2d 901 (8th Cir. 1961) that no private right of action existed under either the Investment Company Act or the Investment Advisers Act. This case was decided before *J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964), which held that there was an implied right of action under § 14(a) of the Securities Exchange Act of 1934. However, in 1967, the *Brouk* holding was eroded in *Greater Iowa Corporation* v. *McLendon,* 378 F.2d 783 (8th Cir. 1967), in which the Court of Appeals, referring to *Borak* and the trend in other circuits, stated that there were strong indications that, if given the opportunity, the Supreme Court would overrule *Brouk* and that "should the necessity present itself [the Eighth Circuit] would carefully review the position taken in *Brouk* in the light of the law as it may then exist." *Id.,* at 793.

The instant case presents the opportunity for this Court to settle the matter and to establish the private right of action plainly called for by the statutory scheme and existing precedents.

In *Colonial Realty Corp.* v. *Bache & Co.,* 358 F.2d 178, 181 (2d Cir. 1966), the Court of Appeals for the Second Circuit outlined the standards under which a private right of action could be implied under the Securities Laws when such a right was not expressly spelled out in a particular statute. Among other things, the implication of a private right of action "may be suggested by explicit statutory condemnation of certain conduct and a general grant of

jurisdiction to enforce liabilities created by the statute . . . or from such considerations as the protection intended by the legislature and the ineffectiveness of existing remedies, administrative and judicial, fully to achieve that end." The instant case falls squarely within these guidelines.

Petitioners have been damaged by their counselor's failure to supervise their accounts continuously and to make and keep proper records pertaining to them. They have no adequate remedy other than a private action for damages against the adviser.

In *Borak, supra,* at 431-2, this Court found a private right of action to exist for violation of § 14(a) of the Securities Exchange Act of 1934. The right of action derived from, among other things, the "broad remedial purposes" of that section, as evidenced by the language which made it "'unlawful for any person . . . to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security . . . registered on any national securities exchange in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest *or for the protection of investors.*'" (Emphasis appears in the Supreme Court's opinion.) Substantially identical language appears in the Investment Advisers Act in several places.

> "Every investment adviser who makes use of the mails or of any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser (other than one specifically exempted from registration pursuant to section 80b-3(b) of this title), shall make, keep, and preserve for such periods, such accounts, correspondence, memorandums, papers, books, and other records, and make such reports, *as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors.* Such accounts, correspondence, memorandums, papers, books, and other records shall be subject at any time

or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission *as the Commission may deem necessary or appropriate in the public interest or for the protection of investors.*" (Emphasis supplied.) § 204, 15 U.S.C. 80b-4.*

"It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. *The Commisison shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive or manipulative.*" (Emphasis added.) § 206(4), 15 U.S.C. § 80b-6(4).

"The Commission, by rules and regulations, upon its own motion, or by order upon application, may conditionally or unconditionally exempt any person or transaction, or any class or classes of persons, or transactions, from any provision or provisions of this subchapter or of any rule or regulation thereunder, if and to the extent that such exemption is *necessary or appropriate in the public interest and consistent with the protection of investors* and the purposes fairly intended by the policy and provisions of this subchapter." (Emphasis supplied.) § 206A, 15 U.S.C. 80b-6a.

As this Court held, in *Borak:*

"We, therefore, believe that under the circumstances here it is the duty of the courts to be alert to provide such remedies as are necessary to make effec-

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* This section was amended June 4, 1975. However, the unamended section is cited in this petition as it was the section in force when the instant case was decided on March 12, 1975.

tive the congressional purpose. As was said in *Sola Electric Co.* v. *Jefferson Electric Co.*, 317 U.S. 173, 176 (1942):

> 'When a federal statute condemns an act as unlawful, the extent and nature of the legal consequences of the condemnation, though left by the statute to judicial determination, are nevertheless federal questions, the answers to which are to be derived from the statute and the federal policy which it has adopted.'
>
> . . . It is for the federal courts 'to adjust their remedies so as to grant the necessary relief' where federally secured rights are invaded. 'And it is also well settled that where legal rights have been invaded, and a federal statute provides for a general right to sue for such invasion, federal courts may use any available remedy to make good the wrong done.' *Bell* v. *Hood*, 327 U.S. 678, 684 (1946)." (*Id.*, at 433*)

The identical considerations apply in the instant case. As the United States District Court for the Southern District of New York held, in *Bolger, supra*, at 263:

> "The Advisers Act was the last in a series of federal legislation designed to eliminate certain abuses in the securities industry, abuses which Congress determined had contributed to the 1929 stock market crash and the depression of the 1930's. 'A fundamental purpose, common to these statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry.' *Securities and Exchange Commission* v. *Capital Gains Bureau, Inc.*, 375 U.S. *supra* at 186, 84 S.Ct. at 280.

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* See also, *Supt. of Insurance of New York* v. *Bankers Life and Casualty Co. et al.*, 404 U.S. 6 (1971) (Right of action implied under § 10(b) of Securities Exchange Act and Rule 10b-5 promulgated thereunder.)

This Act, along with the Investment Company Act of 1940, was spawned by an exhaustive study and report of investment trusts and investment companies undertaken by the Securities and Exchange Commission pursuant to Section 30 of the Public Utility Holding Company Act of 1935 (15 U.S.C. § 79z-4).

"On the basis of this study, Congress determined that persons who paid for investment advice needed protection from dishonest and self-dealing advisers. Thus the Senate Report supporting the enactment of this legislation stated:

> 'The nature of the functions of investment advisers, their increasing widespread activities, their potential influence on security markets and the dangerous potentialities of stock market tipsters imposing upon unsophisticated investors, convinces this Committee that protection of investors requires the regulation of investment advisers on a national scale.' S. Rep. No. 1775, 76th Cong., 3d Sess., at 21 (1940).

"This view was echoed by the House Report which declared that the Advisers Act was designed to:

> '. . . protect the public from the frauds and misrepresentations of unscrupulous tipsters and touts and to safeguard honest investment advisers against the stigma of the activities of these individuals by making fraudulent practices by investment advisers unlawful.' H.R. Rep. No. 2639, 76th Cong., 3d Sess., at 28 (1940)."

The courts have long recognized the existence of a private right of action for a violation of a statutory duty or liability, *Greater Iowa Corporation* v. *McLendon, supra,* at 789. The Restatement (Second) of Torts § 286 (1965) states the principle as follows:

> "The court may adopt as the standard of conduct of a reasonable man the requirements of a legislative

enactment or an administrative regulation whose purpose is found to be exclusively or in part

"(a) to protect a class of persons which includes the one whose interest is invaded, and

"(b) to protect the particular interest which is invaded, and

"(c) to protect that interest against the kind of harm which has resulted, and

"(d) to protect that interest against the particular hazard from which the harm results."

On this basis, too, a private right of action is implied.

It would be anomalous to deny clients of investment advisers the right to recover damages sustained as a result of a violation of the Advisers Act when private rights of action have been implied by the Supreme Court under other Federal Securities laws. The Securities and Exchange Commission has observed that private litigation serves as a valuable adjunct to Commission enforcement action. *Statement of the Securities and Exchange Commission in Support of Proposed Amendments to the Investment Advisers Act of 1940,** pp. 19-20. In this submission, the SEC takes the position that a private right of action may be maintained, but that in view of the conflict among the lower federal courts, the matter should be resolved by the Congress. We contend that the question should be settled by this Court in justice to petitioner's rights, and consistent with this Court's role in the development of the law in this area.

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* This statement was submitted along with various legislative proposals to both Houses of Congress on December 11, 1975.

II. The decision below, that a written investment counsel contract may be orally amended, is contrary to the provisions of the Investment Advisers Act of 1940 and destructive of the proper enforcement of its anti-fraud provisions.

The Congress, in passing the Investment Advisers Act of 1940, found that investment advisers, and their contracts with advisees, were of national concern. Act, § 201, 15 U.S.C. § 80b-1.

Of particular concern were those advisers holding themselves out as "investment counsel." As to these, the Act provided:

> "It shall be unlawful for any person registered under section 80b-3 of this title to represent that he is an investment counsel or to use the name 'investment counsel' as descriptive of his business unless (1) his or its principal business consists of acting as investment adviser, and (2) a substantial part of his or its business consists of rendering investment supervisory services." (§ 208(c), 15 U.S.C. 80b-8(c).)

"Investment supervisory services" were defined as:

> ". . . the giving of continuous advice as to the investment of funds on the basis of the individual needs of each client." (§ 202(a)(13), 15 U.S.C. 80b-2(a)(13).)

During the Senate hearings considering the Act, members of the industry expressed concern about a segment of their industry which they considered "tipsters" and "touts," but called themselves "investment counsel." Investment counselors considered themselves professionals who furnished clients personalized, competent, unbiased and continuous advice regarding the sound management of their investments. It was to foster the development of a professional relationship between investment counselors and their clients (i.e., a personal, responsible relationship) that

the concept of "investment counsel" became the primary focus of the Act.*

The District Court's decision as affirmed by the Court of Appeals below, if allowed to stand, is authority which guts the enforcement scheme. The decision below permits investment counsel to enter written contracts to furnish "investment supervisory services," yet later to testify (as in the instant case) that in a normal conversation, nowhere memorialized, the advisee said he wanted some lesser services, thus excusing the investment counsel's failure to furnish the contracted-for "investment supervisory services."

Failure to give contracted-for "investment supervisory services" is violative of the Act in that the adviser misrepresents the material facts as to what services the advisee is entitled and as to what analyses and other preparation, if any, the adviser has made prior to submitting advice. *Cf. Matter of Chase Investment Services of Boston, Inc., John P. Chase, Inc., et al.*, Investment Advisers Act of 1940 Release No. 449 (March 28, 1975).

In *S.E.C.* v. *Capital Gains Bureau*, 375 U.S. 180 (1963), this Court discussed the purpose of the Advisers Act, and gave full scope to its broad remedial purposes.

> "The Investment Advisers Act of 1940 was the last in a series of Acts designed to eliminate certain abuses in the securities industry, abuses which were found to have contributed to the stock market crash of 1929 and the depression of the 1930's. It was preceded by the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, and the Investment Company Act of 1940. A fundamental

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* H.R. Doc. No. 477, 76th Cong., 2d Sess. (1939); S. Rep. No. 1775, 76th Cong., 3rd Sess. (1940); Hearings on H.R. 10065, Before a Subcommittee of the House Comm. on Interstate and Foreign Commerce, 76th Cong., 3rd Sess. 28 (1940). See also Loomis, *The Securities Exchange Act of 1934 and the Investment Advisers Act of 1940*, 28 Geo. Wash. L. Rev. 214, 248-249 (1959).

> purpose, common to these statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry. As we recently said in a related context, 'It requires but little appreciation . . . of what happened in this country during the 1920's and 1930's to realize how essential it is that the highest ethical standards prevail' in every facet of the securities industry. *Silver* v. *New York Stock Exchange,* 373 U.S. 341, 366." (*Id.* at 186-7).

The Court quoted approvingly from the report of the Securities and Exchange Commission to the Congress prior to the passage of the Act. The Court, noting that the report incorporated the Code of Ethics and Standards of one of the leading investment counsel associations, stated:

> "These canons were adopted 'to the end that the quality of services to be rendered by investment counselors may measure up to the high standards which the public has a right to expect and demand.'" (*Id.*, p. 189)

The Court further noted that the original bill before the Congress stated in its "declaration of policy":

> "Upon the basis of facts disclosed by the record and report of the Securities and Exchange Commission . . . it is hereby declared that the national public interest and the interest of investors are adversely affected— . . .
>
> (4) when the business of investment advisers is so conducted as to defraud or mislead investors, or to enable such advisers *to relieve themselves of their fiduciary obligations to their clients.*" (Emphasis supplied.) (*Id.*, p. 189)

In *Chase Investment Services, supra,* the Securities and Exchange Commission brought an enforcement proceeding against Chase, Inc. (the respondent in the instant case) and related entities. Chase, Inc. and the other defendants in the SEC's action consented (without admitting or denying

the allegations) to an order and remedial sanctions shortly after the District Court decision below in this case. The allegations of the SEC included that the Chase-related parties had misrepresented the material facts that clients would receive personalized investment counsel, tailored to the clients' individual requirements, comparable to that furnished to large accounts. In fact, ". . . clients did not get personalized treatment. No inquiry was made about their personal needs, financial requirements, tax situations, and ability to bear risks. When such information was obtained, it was disregarded. When funds were not placed in equities, cash balances in clients' accounts lay idle and wholly unproductive." *Id.* at 3.

This is, of course, precisely what Chase, Inc. misrepresented to petitioners here in violation of § 206 of the Act, 15 U.S.C. § 80b-6.

Section 204 of the Investment Advisers Act, 15 U.S.C. § 80b-4, requires an investment adviser to "make, keep and preserve" such records as the Commission may prescribe as necessary for the protection of investors. Rule 204-2(a)(10), 17 C.F.R. § 275.204-2(a)(10) under the Investment Advisers Act requires advisers to "make and keep . . . all written agreements (or copies thereof) entered into by the investment adviser with any client . . ." It is clear from this language that oral contracts or oral modifications of written contracts violate this section. Indeed, the Act provides that any purported contract in violation of the Act shall be void. § 215(b), 15 U.S.C. 80b-15. If the decision below is allowed to stand, an adviser will be allowed to evade his responsibilities under the Act, and no appropriate sanctions will exist to protect an investor.

The contract between the petitioners and their investment counselor had a specific clause which prohibited any modification without written notification of the proposed change. However, even if the contract had not contained such a clause, a purported oral agreement may not be used to vary the terms of a written contract if the agreement

contradicts the written provisions of the contract. *Jones Memorial Trust* v. *Tsai Investment Services, Inc.*, 367 F. Supp. 491, 499 (S.D.N.Y. 1973). In the instant case, the alleged modification does not merely fill in or explain the terms of the written contract but directly contradicts them. The contract says that the counselor is to provide continuous supervisory service for the accounts. The "modification," by contrast, denies that the clients are entitled to such services.

This Court should grant the writ in order to hold, in aid of the statutory scheme, that advisers' contracts may not be orally amended, and that failure to provide the services represented to be provided is in violation of the Act.

CONCLUSION

For the reasons given, petitioners pray that a writ be granted to review the judgment below.

Respectfully submitted,

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February 14, 1976

Appendix A, Opinion and Findings, United States District Court, Southern District of New York.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

73 Civ. 2530(MP)

THE ANDERSON COMPANY and ALICE SCRANTON EASTMAN ANDERSON,

Plaintiffs,

v.

JOHN P. CHASE, INC.,

Defendant.

#42027

APPEARANCES:

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MILTON POLLACK, District Judge.

This is a private damage suit against a registered investment adviser to recover trading losses incurred by plain-

tiffs which are claimed to have resulted from the alleged faults and omissions of the adviser in the investment counsel provided during the period November 1966 to February 1971. Jurisdiction is laid on the Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 *et seq.* Pendent common law claims are also asserted for alleged breach of contract, breach of fiduciary duty and fraud. The case was tried to the Court without a jury on November 11, 12 and 13, 1974. Decision was reserved at the close of trial.

I. *The Background*

There are two plaintiffs in this case: The Anderson Company ("Company" hereafter) and Alice Scranton Eastman Anderson ("Mrs. Anderson" hereafter). The Company is a Massachusetts limited partnership. During the period in question, it had no employees and its business essentially consisted of investing its capital. Part of the Company's assets consisted of real property, and during the period Fall 1966-Spring 1967 it attempted to sell or borrow on those assets in order to increase the amount of cash available to it for investment. Douglas S. H. Anderson ("Anderson" hereafter) was the managing general partner. His mother, Mrs. Anderson was a general partner up to April 1967 and has been a limited partner since then. Anderson's wife, Elizabeth R. Anderson has been a limited partner since April 1970. In addition to managing the partnership, Anderson held a power of attorney from his mother for the management and investment of her personal property.[1]

[1] Anderson was also co-trustee along with John S. Whipple, Esq. of the trust of Anderson's late father. The trust also became a client of John P. Chase, Inc., but did not join in the present suit. No reason for this appears in the record, although it may be assumed that the consent of Anderson's co-trustee would have been required before suit could have been brought on the trust's behalf.

Appendix A, Opinion and Findings, United States District Court, Southern District of New York.

Anderson is presently employed by Sterling, Grace & Co. as Director of Export Development with responsibilities in the area of public offerings, private placements, mergers and acquisitions. Anderson entered the securities field in mid-1959 after leaving the family engineering and manufacturing business. He began by taking courses on corporate finance and investments and in early 1960 became associated with the investment banking firm of Lehman Brothers in their Industrial Department, working on private placements, public offerings, venture capital, mergers and acquisitions. Anderson was self-employed for approximately a year beginning in Fall 1962 while he worked on private placements with an associate who remained at Lehman Brothers. Anderson next worked for three and a half years, again in the investment banking area, for a brokerage house recently started by a friend. When that firm was acquired by Legg & Co. in 1967, Anderson moved to the broker-dealer firm of Salomon Brothers & Hutzler for nine months where he worked primarily on public offerings. Shortly thereafter, Anderson returned to Legg & Co. and was put in charge of a one-man department in New York concerned with new business in the area of private placements of securities and corporate acquisitions. Legg & Co. consolidated with Mason & Co., another brokerage firm, and Anderson's employment was terminated in November 1970. He then moved, along with some prospective business, to a small brokerage firm where he stayed for a year and a half. Anderson left in July 1972 for another brokerage house where he continued to work on public offerings, private placements, venture capital, mergers and acquisitions. He moved to Sterling, Grace & Co. in January 1973. During much of his employment in the securities field, Anderson has worked on an incentive and commission basis.

Appendix A, Opinion and Findings, United States District Court, Southern District of New York.

The defendant, John P. Chase, Inc. ("Chase, Inc." hereafter) is a Massachusetts corporation registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940. The Chairman of the Board of Chase, Inc. is John P. Chase.

In about September 1966 Anderson became disenchanted with the investment advisory service of Cyrus J. Lawrence & Sons which was supervising his mother's account, and he called on John P. Chase seeking the services of Chase, Inc. for the securities accounts which Anderson was managing. Chase was told that Anderson was seeking the benefit of a flow of the information available to Chase, Inc. that he could use in managing the accounts, that he would evaluate the advice and act on it to the extent that he chose to do so, that he would place all brokerage orders to buy and sell securities, and that Chase would not be called on to exercise any discretionary authority for the accounts.[2]

Anderson's determination to retain full managerial authority is not surprising in light of his background in the investment banking field. His experience qualified him as a sophisticated investor and knowledgeable speculator.[3]

Anderson periodically subscribed to and acted upon the information and advice provided by investment and statis-

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[2] In fact, while the accounts were with the brokerage firm of F. S. Moseley & Co., trading authorizations in favor of John Chase were executed by Anderson, but these were never actually exercised and when Anderson shortly transferred the accounts to new brokers, no new authorizations were given then or thereafter. Nor did Chase, Inc. ever have custody of any of the securities in the accounts.

[3] When Spindler and Anderson were discussing the use of the Chase Fund of Boston as a standard for evaluating the performance of the Anderson Company Account, Anderson confidently asserted to Spindler that he thought that anybody could beat the averages.

tical publications such as *Value Line, Income Builder,* and *Indicator Digest.* Additionally, and during the relationship which he established with the defendant, he sought and obtained and relied on investment information and recommendations from another investment adviser, a number of brokers, and associates in the securities industry.

Anderson's interests in Chase, Inc. stemmed from the reputation of that firm for the successful management of the two Funds whose investments it then supervised, The Chase Fund of Boston and the Shareholders Trust of Boston. Anderson was of the belief that information critical to greater investment success flowed most consistently and most quickly to organizations managing large investment reservoirs. During his first meeting with John Chase, Anderson inquired whether, as a subscriber to the Chase, Inc. advisory service he could expect that the raw material available to the mutual funds managed by Chase, Inc. would also be available to the Anderson accounts. Chase told Anderson that the common denominator within the firm consisted of the Policy Committee, the Research Department, and the Securities Selection Committee and that the results of their deliberations were available to both the Fund managers and the individual account representatives.[4]

The general objectives for the Anderson accounts were discussed, and in the course thereof Anderson indicated that he had sometimes traded on margin. Anderson asked

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[4] As explained by Chase to Anderson, the Policy Committee concerns itself with long and short range economic, social and political trends and their impact on different industries and types of securities. The Research Department devotes its attention primarily to the favored industries and the most attractive securities within those industries and makes recommendations to the Securities Selection Committee which approves, subject to a final check by the Policy Committee, the individual securities on the approved lists distributed to account supervisors.

Chase how he felt about margin trading and short selling, and in response thereto, Chase stated plainly and unequivocally what was the defendant's unwavering policy throughout the history of the Anderson-Chase, Inc. relationship: both margin trading and short selling were against firm policy.[5] Chase clearly stated that he would not serve a margin account[6] nor would he undertake to counsel any account where short selling was a part of his responsibility. This was reiterated in the cover letter when the contract between the parties was mailed to Anderson for consideration.

Thus from the beginning of their relationship two key facts were abundantly clear to the parties: (1) Anderson retained complete authority and discretion to select, make and time the investment decisions and commitments for the accounts, while Chase, Inc. was to render counselling within the framework of objectives outlined by Anderson and (2) margin transactions and short selling were disapproved and not to be a part of Chase, Inc.'s responsi-

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[5] Chase indicated that he thought that the risks of the market were substantial enough without exacerbating them by such practices. The Chase, Inc. brochure which was given to Anderson emphasizes the importance of basing sound investment decisions on long-term trends and states that the firm does *not* attempt to capitalize on short-term price movements in the stock market.

[6] At this time, the size of the Anderson accounts taken together was well below the Chase, Inc. minimum of $500,000, and Anderson indicated that the accounts could be brought up to the minimum through the sale of real estate or securities based thereon which he expected to complete by the end of 1966. On that basis, Chase consented to an exception to the policy against margin for that limited period, and he had not expected that there would be any debt by the end of 1966. However, as indicated below, neither of the plaintiffs' accounts carried securities on margin at the beginning of the relationship, nor during the first four months of the employment of Chase, Inc.

bility. Indeed, throughout their relationship, Anderson accepted the Chase, Inc. recommendations only to the extent that he himself agreed with them after conducting his own independent research, either through the statistical digests to which he subscribed or by consultation with his associates in the securities industry and his brokers.

The written agreement which the parties entered into, effective as of November 1, 1966, provided that the defendant was retained:

> . . . as investment manager to analyse and supervise the investment accounts . . . and to advise us concerning any changes in the investments which you may consider expedient with reference to the state of these accounts and to market conditions.
>
> . . . [W]e agree to inform you of all future changes therein. It is understood that you assume no responsibility for action taken or omitted in good faith if negligence, willful or reckless misconduct, or violation of applicable law, including the Federal securities laws, is not involved.

The agreement was made mutually revocable at any time upon written notice. Chase, Inc. appraised the market value of the securities in Mrs. Anderson's account at $102,165 as of October 6, 1966 and at $61,407 for the Company account. Chase, Inc. assigned Herbert Bancroft to the three Anderson accounts, and he served from inception of the relationship through April 1967 (a period which Anderson seems to consider the halcyon days of the relationship), when Richard Spindler was assigned to the accounts.

Late in 1967, Anderson became dissatisfied with the services being provided by Chase, Inc. The stock market was in a declining phase and Anderson was apparently

impatient. He decided, as he had a right to do at any time, to terminate the contractual relationship with respect to the Company's account, but not his mother's account, as of December 31, 1967. Anderson then employed Parfield & Company, an unregistered California firm, to obtain investment advice for his management of the Company's assets. At the suggestion of Parfield, Anderson transfered the brokerage accounts to Eastman Dillon. The relationship with Parfield lasted seven months. On advice of Parfield, Anderson made two short sales of securities through her brokerage firm on behalf of Mrs. Anderson's account. He also had made one short sale for her account just before he retained Parfield. These short transactions were made by Anderson without the knowledge of Chase, Inc. that they would be made, and contrary to its declared policy.

About four months after the contract with Chase, Inc. was entered into, and without its knowledge that such transactions would be made contrary to its declared policy, Anderson began to buy stocks at a brokerage firm on margin for the Company and for Mrs. Anderson. He also made some margin transactions thereafter from the Spring of 1967 through February 1971.

In July of 1968, Anderson inquired about re-employing the services of Chase, Inc. for the Company account. He testified that he did so because of an increase in the Chase, Inc. minimum fee in February 1968 from $1,000 to $2,500 which still had to be paid by the other two Anderson accounts. A further and better explanation may lie in his probable disillusionment with the results from the Parfield relationship and his general restiveness. At all events, an agreement was reached concerning the terms on which Chase, Inc. would take back the Company account following discussions between Anderson and Chase.

At the time that Anderson inquired about returning the Company account to Chase, Inc., the defendant's employees were aware that Anderson had engaged in both short selling and margin purchases in both his mother's and the Company's accounts. At a meeting with Anderson, Chase indicated that this was inconsistent with the original agreement, that he did not believe that Anderson was getting the full benefit of Chase, Inc.'s services, and that he would not take back the Company account unless Anderson would adhere at once and henceforth to the basic agreement that there would be no short selling and no use of margin to purchase securities. Anderson agreed to do so. It was on this basis that Chase persuaded Spindler to reassume responsibility for the Company's acccount. Again, Anderson told Spindler that what he wanted from Chase, Inc. was a flow of information that he could adapt for his own use in managing the family accounts. By letter of July 23, 1968, Anderson cancelled his termination letter of January 10, 1968 in respect to the Company account.

Spindler served the two accounts until late 1968 when he assumed other duties in the Chase, Inc. organization. Henderson Inches succeeded Spindler and advised the accounts through February 1971 when Anderson terminated the advisory relationship altogether. It is primarily during the tenure of Inches that the faults and omissions charged by the plaintiffs allegedly occurred.

At the time that Spindler left the accounts in late 1968, he felt that the relationship should not be continued because it was difficult to keep track of what was going on in the Anderson brokerage accounts and because less and less attention was being given to Chase, Inc.'s recommendations. Indeed, through the relationship with Chase, Inc., but particularly in the later period, Anderson on occasion simply decided (as he had the right to do) not to follow the

Chase, Inc. recommendations. Chase told Anderson that their services would not be continued unless an agreement could be reached clarifying what kind of service Anderson wanted Chase, Inc. to render. Inches, the new account representative, and Anderson met to discuss Anderson's requirements. Anderson indicated that what he wanted from Chase, Inc. was a flow of its ideas through verbal and personal contact with Inches in order to contemporaneously get the benefit of the Policy Committee's basic investment policies, the Research Department's findings and the Security Selection Committee's materials. It was thereupon agreed that Anderson and Inches would follow a system of phone calls and face-to-face communications on those policies, findings and materials and that written recommendations would no longer be required or constitute a part of the Chase, Inc. service. As part of the agreement, Anderson would be entitled also to make inquiries concerning various securities which he might hear about from his other sources and Chase, Inc. would provide information to the extent that its organization covered the particular stocks. In addition, Chase, Inc. would give Anderson recommendations of particular stocks that Chase, Inc. found attractive based upon the particular objectives of each account and would provide him with its regular reports on the economic and stock market outlook.

Although Chase, Inc. was willing to give Anderson the benefit of its advice as to the attractiveness of a particular stock, it was not willing during this period to make recommendations involving any certain number of shares or any certain amount of money since they did not know and were not being told where the money to pay for the shares would come from, whether it was margin, short selling or whatever. Reaffirming Chase, Inc.'s longstanding policy, Inches specifically told Anderson that Chase, Inc. would not rec-

ommend any transactions involving short positions or other types of hedged positions for the Anderson accounts.

Anderson's response to the testimony of Chase and Inches, that they had met with him in December 1968 to January 1969 and discussed and thus arranged the manner in which Chase, Inc. was to handle the accounts, was to claim a lack of recollection of the meetings. The testimony on defendant's behalf seems credible and corroborated by the circumstances and probabilities and is therefore accepted by the Court.

Notwithstanding the repeated promises made by Anderson to Chase that he would not engage in margin purchasing or short selling, during June-July 1969, Anderson engaged in two short sale transactions (profitable ones) on behalf of the Company. In early and mid-May 1970, Anderson made approximately 20 additional short sales, on behalf of the Company, roughly one-quarter of which were so-called "naked" shorts.[7] He covered these short transactions, most of them profitably, by market purchases at the end of the month. At the same time, he made 10 new "naked" short sales on behalf of the Company, all of which he covered almost immediately by market purchases, but this

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[7] A short sale is an order by an individual to his broker to sell presently a specified number of shares held by the broker in return for the individual's promise to replace the securities sold at a later date. The proceeds of the sale are held by the broker pending receipt of the shares promised by the seller. A "naked" short sale is a short sale of shares which the seller does not presently hold. A short sale "against the box" is a short sale of shares which the seller does presently hold. A naked short sale is completed by covering through a market purchase of the shares due. A short sale against the box provides the option of either covering by a market purchase as with the naked short or delivering the shares held against the shares due. In the present case, a short sale against the box has been characterized by the plaintiffs as a hedge against a further decline in the market price.

time uniformly with losses. June again saw more than 20 short sales made by Anderson on behalf of the Company, approximately two-thirds "against the box". Some of these transactions were completed by Anderson through market purchases in September at a profit, but most of these short sales were still uncovered at the time of the termination of the Chase, Inc. relationship by Anderson in February 1971 and the shorts were later covered, generally by market purchases at substantial losses. The same pattern of short transactions continued, though to a lesser extent, in October and November 1970. The February 28, 1971 statement of the Company's brokers, Eastman Dillon, indicates that at the time of termination the Anderson Company had short sale obligations outstanding in 19 securities. Roughly two-thirds of these positions were naked shorts. The Company ultimately realized a loss of roughly $48,000 on the naked shorts and a loss of roughly $27,540 on the shorts for which there was stock in the box, many of which were covered by market purchases rather than by delivery from the box.[8]

A similar pattern of short sales with respect to timing and the securities involved also appears in Mrs. Anderson's account during this period, although Anderson engaged in fewer short sales on behalf of his mother.

The disastrous monetary effect of Anderson's speculation in 1970-71 on the short side of the market is simply appraised by an examination of the tax returns filed by the plaintiffs setting out the results of the transactions

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[8] The figures in this paragraph are taken from both the Anderson Company's tax returns and its brokerage statements from Eastman Dillon. Minor discrepancies between the two stem from the fact that Anderson apparently recorded, for example, two short transactions in the same security on the same or proximate days as a single transaction on the tax returns, while the brokerage statements list them separately.

made by Anderson. These indicate:

		Anderson Company		
Fiscal		*Gain*	*(Loss)*	*Net Gain or (Loss)*
1970	S	14,278	L(25,259.62)	(10,991.57)
1971[9]		—	S(140,699.80)	
			L(24,309.58)	(164,009.38)

In contrast to the table, the Company had no losses at all in securities transactions for its fiscal years 1966-69; it reported net gains in each year of the period, totalling $66,566.55.

Mrs. Anderson's account reported for the period 1966/69 gains in each of two years totalling $40,916.19 and a loss in one year of $1,375.71 or a net gain of $39,540.48. This account also sustained a loss of $2,585.61 in 1970 so that the net for almost the entire period of the relationship with Chase, Inc. was a gain of $36,954.87.[10]

The short transactions in the two accounts resulted in over $200,000 of combined losses in 1970-71. Anderson was solely responsible for initiating these short sales. He personally guessed wrong on the market course of the stocks he sold, believing that they were going down when in fact they went up. He engaged in over 120 short transactions in this period, which was both before and after the employment of Chase, Inc. terminated, against the initial and continuing advice of Chase, Inc. and his repeated assurance to them when they learned what he was

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[9] Includes short covering of earlier trades as well as transactions after termination in February 1971 of the relationship with Chase, Inc. The Anderson Company's fiscal year ends on April 30th of the succeeding calendar year.

[10] Mrs. Anderson reported a loss of $2,114.74 for 1971 which included transactions after the termination of the relationship with defendant in February 1971.

doing that he would not buy on margin or sell stocks short. Indeed, as the Company's tax return Schedule D for 1971 indicates, Anderson actually made most of the short sales resulting in such heavy losses *after* he had terminated the agreement with Chase, Inc.[11] This case was filed not too long after the last of the huge losses registered on the short sales.

II. *The Investment Advisers Act of 1940*

Plaintiff's approach to liability in this case under the Investment Advisors Act seems to be twofold: (1) reference to a general underlying theme of fiduciary duty imposed by the Act on Chase, Inc. to protect the interests of the plaintiffs by rendering continuous "investment supervisory services" and (2) resort to the general antifraud provisions of § 206, 15 U.S.C. § 80b-6.

"Investment supervisory services" is defined in Sec. 202 (a)(13) of the Act, 15 U.S.C. Sec. 80b-2(a)(13) as "the giving of continuous advice as to the investment of funds on the basis of the individual needs of each client."[12] How-

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[11]Plaintiffs have sought to minimize Anderson's short trading and to give it a sophisticated gloss by suggesting that he was intelligently hedging stock ownership by short selling and that there is a distinction between "naked" short sales and short sales against stocks held in the box by the Company and Mrs. Anderson. They characterize the latter type as "hedged positions" designed to eliminate the risk from holding securities. The distinction, if there is one, is irrelevant in this case. A short sale is a short sale no matter how delivery against the sale is to be made. Anderson almost invariably covered the short positions by market purchases of the stock to be delivered. These transactions were not a hedge nor did they minimize the risk.

[12] SEC Form ADV defines the term, in question 18(a), as "the giving of continuous advice to clients as to the investment of funds on the basis of individual needs of each client . . . e.g., the

(footnote continued on following page)

ever, it does not appear that the Act makes the full panoply of "investment supervisory services" a mandatory, implied term of every contract for services. The role of the term "investment supervisory services" in the statutory scheme appears to be a purely descriptive one with respect to the nature of the registrant's business for the purpose of filing with the SEC. 15 U.S.C. Sec. 80b-3(c)(2). Similarly, Sec. 208(c) of the Act, 15 U.S.C. Sec. 80b-8(c) prohibits a registrant from using the name "investment counsel" as a description of its business unless its principal business consists of acting as investment adviser and a substantial part of its business consists of rendering investment supervisory services. The statute does not say that all individual clients must receive the full panoply of "inment supervisory services". Indeed, there would appear to be no reason for mandating such a standard across the board as long as the particular agreement is not inherently fraudulent and the parties clearly understand the nature of the services to be provided. Similarly stated, there is no reason why Chase, Inc. should be required to provide the full panoply of "investment supervisory services" when Anderson himself had already determined in advance what he wanted and that his individual needs required only a flow of investment information.[13] Thus the parties were free to contract for the particular nature of the investment

(footnote continued from preceding page)

nature and amount of other assets, investments and insurance, and the nature and extent of the personal and family obligations of each client."

[13] Plaintiffs make much of the fact that Chase, Inc. stated in its Form ADV that none of its clients received services other than "investment supervisory services" as defined by the SEC (see footnote 12, *supra*). Regardless of whatever complaint, if any, the SEC may have on this score against Chase, Inc., it cannot be contended on this record that Anderson did not understand the type of service that he had bargained for with Chase, Inc.

supervisory service to be provided, and as indicated in the preceding section, they indeed mutually agreed upon a far less extensive investment service than that represented by the full panoply of "investment supervisory services" which plaintiffs presently discuss.

The cases cited by plaintiffs in support of their implicit contention that the fiduciary duty imposed on investment advisers obligates them to provide all clients with the full panoply of "investment supervisory services" regardless of the terms of the individual agreement, involved various types of self-dealing by the investment adviser. Since there is not even the slightest hint of self-dealing in the present case, these decisions are inapposite. *See, e.g., SEC* v. *Capital Gains Bureau,* 375 U.S. 180 (1963) (scalping); *Rosenfeld* v. *Black,* 445 F.2d 1337 (2d Cir. 1971) (sale of advisory office), *cert. dismissed* 409 U.S. 802 (1972); *Charles Hughes & Co.* v. *Securities and Exchange Commission,* 139 F.2d 434 (2d Cir. 1943), *cert. denied,* 321 U.S. 786 (1944) (sales to brokerage customers at prices above the prevailing market).

While Chase, Inc. may not have been required by the Act itself to provide the Anderson accounts with the full panoply of "investment supervisory services", the theoretical possibility remains that Chase, Inc. itself may have represented that it would provide such service, as plaintiffs contend, or may have otherwise misrepresented the nature of the services that it would provide. The general antifraud provision of the Act, Sec. 206, 15 U.S.C. Sec. 80b-6, provides that:

> It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—
>
> (1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client; . . .

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

On the basis of the evidence presented, the Court concludes that Chase, Inc. made no misrepresentation of the scope of the services to be provided to Anderson; it did not represent to Anderson that it would provide the full panoply of "investment supervisory services" suggested by the Act and the SEC. Anderson quite clearly asked Chase, Inc. to provide a much more limited type of service, and the numerous discussions that he had with Chase, Spindler, and Inches on this very point leave no doubt that there could not have been any misunderstanding on Anderson's part. Indeed, the Chase, Inc. brochure to which Anderson refers plainly states that "[e]ach account is counselled according to its individual needs, objectives and *restrictions.*" (emphasis added)

The Court will nonetheless proceed to consider plaintiffs' contention that the alleged representation that Chase, Inc. would act as "investment counsel" and would render "investment supervisory services" was false since it provides a convenient means for considering whether Chase, Inc. might otherwise have misrepresented the services that it agreed to provide or might have failed to perform the particular services that it did agree to provide. Plaintiffs as-

sert that this representation was false in two respects: (1) Chase, Inc. was incapable of rendering "investment supervisory services" because its systems and procedures were deficient, and (2) Chase, Inc. knowingly and unilaterally determined to cease attempting to provide such service without so informing Anderson.

With respect to the systems and procedures of Chase, Inc., plaintiffs allege deficiencies in six categories (some of which overlap): (1) obtaining and updating information concerning the accounts and their principals, (2) determining, analyzing, reviewing and centrally recording the objectives of the accounts, (3) evaluating the tax impact of recommended transactions, (4) avoiding the adverse effects of large transactions by the Chase, Inc. mutual funds on the individual accounts, (5) monitoring the cash available for investment, and (6) understanding the term "investment supervisory services" by Chase, Inc. personnel.

The primary record that Chase, Inc. maintained for each account was the so-called black book. The black book consisted of a divider page identifying the account and its objectives; copies of each four month appraisal; investment distribution tables as of each four month appraisal date; a register of the account's progress in terms of appreciation; a listing of the short sales in the case of the Anderson accounts; a cash balance record; originals of written purchase and sale recommendations; tax information cards for each security held by the account; and a carryover form indicating the account's taxable gains and losses for each transaction.

Plaintiffs contend that Chase, Inc. did not make any inquiries of them with respect to their other assets, income, living expenses, or life insurance. Chase, Inc. properly points out that pursuant to the contract it was entitled to rely on Anderson, who was no mere neophyte, to

provide such information as was relevant to the particular, restricted function assigned to Chase, Inc. The type and extent of information that an investment adviser requires depends on the nature of his contractual responsibilities and the customer's expectancy. Since Anderson's requirements and expectancies were for a flow of information from Chase, Inc. rather than investment responsibility and since Anderson retained all management discretion and authority and investment function, Chase, Inc. quite properly perceived that its responsibility to probe was necessarily limited accordingly. Chase, Inc. was entitled to rely on Anderson's contractual obligation to keep Chase, Inc. posted with respect to the affairs of plaintiffs and his investment activities and changes in the Accounts. In the circumstances here presented Anderson simply cannot contend that he would not have known what information concerning other assets, income and expenses of the plaintiffs was relevant to the function assigned to Chase, Inc. or to meet Anderson's expectancies from the engagement.

Plaintiffs' criticism of the procedure for determining and reviewing the objectives of the accounts with Chase, Inc. apparently comes down to the allegedly deficient description on the black book divider page of the Company account's objectives. There is, however, no indication that this alleged deficiency reflected inadequate knowledge of Anderson's and the accounts' objectives by Chase, Spindler or Inches. Anderson and Chase discussed the objectives of the accounts during their first meeting, and Anderson elaborated upon that discussion in his letter of October 5, 1966 to Chase. The divider pages for Mrs. Anderson's account and the trust account contain descriptive paraphrases and quotations from that letter. There is no question as to the propriety of these objectives with respect to the needs of the individual accounts, and Anderson

apparently never communicated any changes in these objectives to Chase, Inc.

Plaintiffs contend that the individual tax cards maintained for each security held by an account are inadequate for federal tax purposes since they show only the average cost per share. This criticism looks only to the top line of the card which is maintained in pencil on a running basis; a look at the lower portion of the cards reveals that it does identify and detail by lot the individual transactions in a manner adequate for federal tax purposes. An additional form which listed the taxable gain or loss on each transaction in the account was maintained in the black book, thus facilitating determination of a running net loss or gain figure for the account at any point. To the extent that Anderson engaged in any taxable transactions in the capital assets of his mother or the Company held outside the accounts with Chase, Inc., it was entitled to rely on Anderson's contractual obligation to provide information concerning changes in the accounts. Again, it cannot be argued that Anderson would not have known whether this information would be relevant. Plaintiffs make much of Inches' inability to remember the origin and correct date of an entry for a $117,000 long term capital gain by the Company outside of its account with Chase, Inc. However, even apart from the problems of incomplete memory four years after the fact, the figure was obtained from Anderson himself and it is not clear from the record who was at fault for the incorrect date.

During the trial, the Court sustained objections to questions by plaintiffs' counsel concerning Chase, Inc.'s lack of a procedure for avoiding the adverse effects on the individual accounts which they handled of large transactions by mutual funds managed by Chase, Inc. on the ground of lack of any foundation with respect to common holdings and

transactions by the mutual funds and the Anderson family accounts. A subsequent offer of documentary evidence to show that the Chase Fund of Boston had sold one-seventh of its holdings in Ampex Corporation at approximately the same time that Mrs. Anderson sold 150 shares was declined by the Court on the ground of lack of relevance hereto.

Plaintiffs criticize the cash records for the accounts on three grounds: (1) the records commenced as of October 6, 1966 for all accounts and again as of July 23, 1968 for the Company account with zero balances, (2) at the conclusion of each four month appraisal period a bookkeeping entry was made to draw the balance down to zero and the true balance was generally not reinstated and (3) Chase, Inc. simply stopped maintaining the record in November 1970 without reason.

The fact that the records began with zero as of October 6, 1966 is not surprising since there apparently was no cash immediately available to the accounts at that time. Chase, Inc. properly argues that to the extent that additional cash became available to the accounts from outside sources, Anderson was obligated by the contract to provide that information to Chase, Inc. on his own initiative. When the Company account was returned to Chase, Inc. in July 1968, Spindler was given an idea of how much cash was available for investment, but neither the source nor the amount of the funds was disclosed by Anderson. Since the Company made purchases of $30,000 and sales of only $3,600 during July and August 1968, the bookkeeping zero balance does not seem to have provided a meaningful omission. The same may be said with respect to plaintiffs' criticism that a formal appraisal was not prepared for the Company account until the regularly scheduled appraisal date of October 4, 1968, rather than immediately upon the return of the account in July.

Plaintiffs' criticism of Chase, Inc.'s failure to restore the cash figure following each appraisal seems exaggerated. The figure for the end of each period was generally listed on the written appraisal which was sent to Anderson. Even if the balance was not formally restored, it was not erased from the ledger and thus was available for ready reference during the succeeding period. Moreover, even if the restoration entry had been regularly made, the figure would still represent only the net of the purchases and sales in the account absent any of the informational input required by the contract from Anderson concerning, for example, additions or subtractions to or from the partnership capital.

The fact that the last entry on the cash record is for November 17, 1970 is simply explained. The Eastman Dillon brokerage statements indicate that there were no purchase or sale transactions by the Company during December 1970 or January 1971. The four short sales made by the Company after November 17th are all recorded on a separate sheet in the black book for the account's short sales. The accounts were terminated as of February 5, 1971.

With respect to the assertion that Chase, Inc.'s senior officers did not understand the statutory meaning of "investment supervisory services", Chase certainly displayed a more than adequate common sense understanding of the term, as did Inches. While Spindler may have been unaware of the statutory definition of the term during his tenure as account supervisor, there is no indication that he did not understand the type of service that was to be provided to the Anderson accounts pursuant to the agreement with Anderson.

Plaintiffs assert five groups of acts or omissions in support of their contention that Chase, Inc. ceased providing plaintiffs with the required services: (1) written memoranda of purchase and sale recommendations were no longer provided, (2) the holdings of the accounts were no

longer reviewed, (3) purchase and use of sale proceeds recommendations were no longer initiated, (4) recommendations became so equivocal as to be useless, and (5) the margin and short sale transactions of the accounts were ignored in rendering advice.

During the Bancroft and early Spindler periods, Chase, Inc. provided written memoranda of its purchase and sale recommendations. However, as indicated in Section I, *supra*, in winter 1968-69 the parties agreed that written recommendations would no longer constitute a part of Chase, Inc.'s service. Contrary to plaintiffs' contention, SEC regulation § 275.204-2(a)(3)[14] under the Act does not require that written confirmations of *oral* recommendations be maintained. While written recommendations would certainly provide a permanent reference and certainly would have been useful in considering the contentions in this case, the fact that they were not continued may not be held against the defendant in light of the agreement and the overall circumstances.

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[14] The regulation provides in relevant part:

(a) Every investment adviser . . . shall make and keep true, accurate and current the following books and records relating to his advisory business: . . .

(3) A memorandum of each *order* given by the investment adviser for the purchase or sale of any security [and] of any instruction received by the investment adviser

concerning the purchase, sale, receipt or delivery of a particular security. . . . Orders entered pursuant to the exercise of a discretionary power shall be so designated. . . .

(7) Originals of all *written* communications received and copies of all *written* communications sent by such investment adviser relating to:

(i) Any recommendation made or proposed to be made and any advice given or proposed to be given. . . . [Emphasis added]

There does not appear to be any prohibition against oral recommendations or a requirement that they be confirmed in writing.

The contention that Chase, Inc. stopped reviewing and monitoring the contents of the accounts is completely contrary to the evidence. During his assignment to the accounts, Inches reviewed the black book not less than twice per week. Anderson testified that he spoke with Spindler and Inches about the accounts on the average of twice a month and that they initiated the conversations roughly half the time. On several occasions, Inches met personally with Anderson in New York to discuss the accounts. The appraisals and cover letters discussing the accounts were prepared by the account supervisor and reviewed by Chase on a regular basis throughout the relationship. The fact that not all the securities held by the accounts were on the Chase, Inc. approved lists is of marginal probative value. It has been established that Anderson was receiving and acting upon investment information and advice obtained from other sources throughout this period. Plaintiffs have been unable to establish that any of the Chase, Inc. account supervisors ever recommended the purchase of any securities by Anderson which were not on the Chase, Inc. approved lists. Indeed, there is extensive testimony to the contrary. Moreover, the fact that a particular security was not on the approved lists simply meant that Chase, Inc. did not follow that security, not necessarily that it was not a good investment.

Plaintiffs also contend that Chase, Inc. neglected to recommend the sale of securities that it ranked "3" or lower. To begin with, a "3" ranking was a hold, not a sell recommendation in the Chase, Inc. internal system. In addition to the oral sell recommendations which were made, the regular appraisal letters also contained recommendations to sell specified securities, as is indicated below.

Plaintiffs' additional criticism of the actions of Chase, Inc. during this period is the allegation that it simply stopped initiating recommendations concerning purchases and the use of sale proceeds. At the time the revised understanding was reached with Anderson in winter 1968-69 Chase, Inc. had agreed to provide appropriate purchase recommendations for the accounts.

Underlying this criticism is the assertion that Chase, Inc. had agreed to provide Anderson only with names of securities to which it assigned a "1" ranking.[15] Plaintiffs further contend that on a number of occasions Chase, Inc. recommended the purchase of securities having a "2" ranking. Both points are misdirected.

The evidence does not support the contention that Chase, Inc. ever undertook to supply recommendations only of securities having a "1" ranking. The "approved" lists which Chase, Inc. used were for internal use as guides for the account managers in making recommendations for particular accounts based on their individual needs and objectives, and were not regularly disseminated to clients. That a particular security was ranked "1" does not necessarily mean that it was appropriate for a particular account to purchase or hold that security. Indeed the October 29, 1969 letter from Anderson to Inches, which is referred to by plaintiffs, clearly indicates that there were a number of "1" ranked securities which Inches did not think were ap-

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[15] The Chase, Inc. internal ranking system had the following meanings:

"1"—most attractive purchase or hold;

"2"—purchase or hold;

"3"—hold, do not purchase;

"4"—permissible switch in the discretion of the account supervisor;

"5"—sell.

propriate purchase recommendations for the particular needs and objectives of the Anderson accounts at that time. Similarly, a particular security ranked "2" on the Chase, Inc. lists could have been a more appropriate purchase recommendation for one of the Anderson accounts than a particular security ranked "1". The flexibility with which the rankings were used is also reflected in the fact that in appropriate circumstances account supervisors could recommend the purchase of securities which were not ranked "1" or "2" if they obtained the prior approval of John Chase. Nothing in the understanding with Anderson precluded such a course.

The Chase, Inc. brochure which was given to Anderson and on which plaintiffs' counsel seeks to mount an argument, emphasized the importance of analyzing the long-term trends in making sound investment decisions for the management of a *portfolio* through the careful selection and review of the constituent securities. The brochure states that Chase, Inc. does not attempt to capitalize on short-term price movements in the stock market. Thus the Chase, Inc. *ranking* system for *portfolio* management may not be equated with the *rating* system for the short term movements of *individual* securities provided by other service organizations.

In their testimony at trial, Chase and Inches did not suggest that purchase recommendations of the nature just described were not forthcoming during 1970, but rather made the point that any suspension thereof initially was attributable to a judgment on the state of the market and later on, the numerous short sales engaged in by Anderson precluded purchase suggestions. Chase stated that at least through the market lows of May 1970, Chase, Inc.'s posture toward the market was a very conservative one, indicating that the appropriate course of action would have been the reduction of bank loans or other indebtedness, investment

in short term obligations, or simply holding cash.[16] Once the short sale transactions appeared in the accounts, Chase, Inc. was reluctant to recommend any purchases until the short positions were removed.

Plaintiffs contend that Chase's letter of November 20, 1970 to Anderson advising him to "cover" the short positions in the next few weeks was in effect the initiation of a purchase recommendation for the particular security because eight of the 18 shorts were sales against securities in the box. However, the Eastman Dillon brokerage statements indicate that the plaintiffs' suggestion is a hypothetical one since Anderson did not cover any of the short sales from the box in any fashion between November and termination in February. Moreover, during the period May to November 1970, Anderson invariably covered his short sales allegedly against the box on his own initiative by covering from purchases on the market rather than delivering from the box (a practice wholly inconsistent with his professed intent to place the accounts in a hedged position).

Any impression that the Chase, Inc. recommendations became so equivocal as to be useless stems primarily from a comparison of the recommendations of the later period of the relationship with the "specific" (i.e., specific as to number of shares and price) recommendations of the Bancroft and early Spindler periods. Chase testified that the firm was unwilling during the later period to assume responsibility for specific recommendations of that nature because they did not know and were not told the source of the funds or what the outstanding obligations of the accounts might be. In that context, Chase, Inc.'s position was entirely

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[16] In this context of market decline, Anderson's October 21, 1969 letter to Inches regarding securities with a "1" ranking assumes even less importance.

reasonable in light of its longstanding policy against margin trading and short sales. Insofar as the written appraisals contained recommendations, they may have been rather general, but they were hardly useless. For example, the November 6, 1970 appraisal letter, indicated that all investments except Anaconda had appreciated during the period and concluded that "overall we believe your investments represent attractive growth vehicles with the exceptions mentioned and discussed on the phone." The letter advised that Chase, Inc. policy was negative toward Anaconda, but that there was no rush in selling it at the then reduced market levels. Similarly, the July 7, 1970 appraisal letter identified four specific securities as reasonably attractive holds and recommended two securities to be switched if there were any real strengthening in the market.

To argue that the margin purchases and short sale transactions were ignored by Chase, Inc. in rendering advice is disingenuous to say the least. At numerous key junctures throughout the Anderson-Chase relationship, Anderson was specifically and emphatically advised not to enter into margin or short sale transactions to begin with or was advised to disengage himself from the transactions that he had already entered into. Chase, Inc. was made aware of the short sales—after they were made—through the Eastman Dillon brokerage statements and recorded them by a separate listing maintained in the black book. While Chase, Inc. would have nothing to do with margin purchases and short sales, their acquaintance with what Anderson essayed to do nonetheless, was ultimately before it to the extent it was apprised thereof in the records utilized for the accounts.

Plaintiffs contend that if Chase, Inc. was unhappy about the margain purchases and short sales it should have terminated the contract as it had an unquestioned right to do. However, this puts the shoe on the wrong foot. The

investment decisions and management were Anderson's—Chase, Inc. was foreclosed therefrom. Chase, Inc. actually raised the question of the margin purchases and the short sales in the context of its right to terminate in July 1968 and Winter 1968-69 when it was attempting to reach mutually satisfactory revisions of the original agreement. On each of these two occasions (as well as others) Anderson represented that such practices would cease. That Chase, Inc. chose to carry out the function assigned to it by Anderson and to leave to Anderson the investment decision and management which he retained for himself is hardly a basis for liability to the plaintiffs.

Plaintiffs also assert a number of what might be called miscellaneous misrepresentations. First, they contend that the statement in the Chase, Inc. brochure given to Anderson that "to assure that each account remains under constant and continuous supervision, two individuals, *one* of whom is *primarily* responsible, are assigned to the investment management of each account" [emphasis added] is false. The brochure quite obviously does not promise the full-time services of two managers. There was no misrepresentation because Inches was in fact primarily responsible for the management of the accounts. When he assumed responsibility for the accounts he talked extensively with John Chase about their management. Thereafter, he spoke with Chase reasonbly often and a number of times with Spindler, his predecessor on the accounts. During Inches' tenure, John Chase regularly reviewed the four-month appraisals and cover letters analyzing the accounts' progress. Chase was particularly involved with the accounts with the disclosure of short selling and the acute problems it brought on for the accounts. Plaintiffs simply cannot contend on this record that there was any interruption in the continuity of the advice rendered to the accounts.

Second, plaintiffs contend that Anderson was misled as to the interchange at Chase, Inc. between the mutual fund management personnel and the individual account counsellors. However, Chase, Inc. never told Anderson that he would be given an inside scoop on what the mutual funds were doing. It was not and never has been Chase, Inc. policy to apply intimate knowledge of the actions and thinking of the Chase of Boston group of Funds to the management of other accounts, and Chase, Inc. never represented to Anderson that such knowledge and thinking would be applied to the Anderson accounts. What Chase, Inc. did represent, and correctly so, was that the common denominator within the firm consisted of the deliberations and determinations of the Policy Committee, the Research Department, and the Securities Selection Committee and that their output became available to both the fund managers and the individual account managers. John Chase did not discourage free discussion between account managers, but did prohibit the use of client's names in such discussions.

Finally, plaintiffs assert that Chase, Inc. may be held liable for the accounts' losses by having ratified purchase "recommendations" initiated by Anderson on the basis of information from his other sources. However, Chase, Inc. agreed to make Inches available as a sounding board for such inquiries only if the firm actually followed the particular security involved. Moreover, in many instances Anderson sought "ratification" of investment advice received elsewhere that he had in fact already acted upon by purchasing or selling the securities that he later asked Chase, Inc. about.

As the parties' briefs indicate, the courts are divided as to whether there is a private right of action in damages under the general antifraud provisions of § 206 of the Act,

15 U.S.C. § 80b-6. *See, e.g., Bolger* v. *Laventhol, Krekstein, Horwath & Horwath,* [1973-74] CCH Fed. Sec. L. Rep. ¶ 94,618 (S.D.N.Y. June 27, 1974), *reh.* ¶ 94,739 (S.D.N.Y. July 29, 1974) (implied right of action for *inter alia* self-dealing); *Courtland* v. *Walston & Co., Inc.,* 340 F. Supp. 1076 (S.D.N.Y. 1972) (semble) (implied right of action for selective pre-publication release of recommendations despite no scalping); *Gammage* v. *Roberts, Scott & Co., Inc.* [Current] CCH Fed. Sec. L. Rep. ¶ 94,761 (S.D. Cal. June 25, 1974) (no private right of action); *Jones Memorial Trust* v. *Tsai Investment Services, Inc.,* 367 F. Supp. 491 (S.D.N.Y. 1973) (dictum) (no private right of action for mere mismanagement as opposed to concealment and misrepresentation); *Greenspan* v. *Del Toro,* No. 73-638-Civ. JF (S.D. Fla. May 17, 1974) (alternative holding) (no private right of action: in any event would be limited to injunctive relief); Note, *Securities-Investment Advisers Act of 1940—Private Right of Action for Damages Allowed Against An Investment Adviser and His Accountant,* 53 Ford. L. Rev. 493 (1974). However, since on the basis of the preceding discussion the Court finds neither fraud[17] nor breach of duty on the part of Chase, Inc., it is unnecessary to decide this question.

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[17] The Court has considered plaintiff's allegations under the essentially similar language of each of the subsections of § 206 and has found that the allegations have not been proven. With respect to the claim of false advertising under § 206(4), 17 C.F.R. §§ 275.206(4)-1(a)(3) and (5), the Court finds that the Chase, Inc. brochure does not constitute false or misleading advertising. The reprint of a talk given by John Chase does refer to a "formula" for investment decisions, but clearly does so in the context of a guideline contemplating consideration of other factors rather than of an investment panacea. The same is true of the manner in which the formula was explained to Anderson.

Appendix A, Opinion and Findings, United States District Court, Southern District of New York.

III. The Common Law Counts

The common law claims rest on the same pattern of alleged acts and omissions by Chase, Inc. which was discussed in the preceding section.

The Court's conclusion in the preceding section that Chase, Inc. did not misrepresent the nature of the services that it would provide carries over to the common law fraud count. Moreover, plaintiffs concede in their post-trial memorandum that the common law standard of scienter is stricter than the statutory standard which has developed under the securities laws. Assuming arguendo that misrepresentations were made, the record in this case is absolutely devoid of any evidence of an intent on the part of the defendant to defraud the plaintiffs. Even if the less restrictive statutory standard[18] were to apply to the common law fraud count, it would nonetheless have to be dismissed on the facts of this case.

By the terms of the written agreement, Chase, Inc. assumed liability for its negligent acts or omissions even if taken or omitted in good faith. On the basis of the evidence in the record in part discussed in the preceding section, the Court concludes that there was no breach, either intentional or negligent, of the contract for the particular services agreed upon by the parties.

Although plaintiffs purport to recognize that to say that one is a fiduciary is only to begin the analysis of his duty, they nonetheless have proceeded to thrust a most stringent standard of obligation on the defendant in almost complete disregard of the nature of the contractual relationship

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[18] Something short of specific intent to defraud, but also something more than mere negligence is required under Rule 10b-5. *Republic Technology Fund, Inc.* v. *Lionel Corporation*, 483 F.2d 540, 551 (2d Cir. 1973), *cert. denied* 415 U.S. 918 (1974).

agreed upon by the parties. Chase, Inc. possessed no authority whatever to act on behalf of either of the plaintiffs. Its role was purely advisory in a very real sense of the word. Nor was it Anderson's sole adviser during this period. In the present context it strains credulity to assert that Chase, Inc. was somehow required to restrain Anderson from engaging in short sales. Chase, Inc.'s only power as a "fiduciary" was that of persuasion, a power it repeatedly exercised to no avail in communicating directly with Anderson and ultimately with the co-trustee of his father's trust.

IV. *Summary*

The plaintiffs have failed to establish by a preponderance of credible evidence or any evidence for that matter that Chase, Inc. is chargeable with any misrepresentations, oral or written, fraud or breach of duty, contractual or statutory. The issues of credibility herein are resolved in favor of the defendant. Anderson's testimony on the controverted matters is not worthy of belief.[19]

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[19] The following colloquy provides a striking example of the generally disingenuous character of Anderson's testimony as to the limited nature of the services to be provided by Chase, Inc.:

> The Court: So in effect then what you are saying is that they were your trustees and that you shouldn't have been let loose to do your own trading?
>
> Witness (Anderson): That's correct. I should have received—
>
> The Court: Is that the contract that you made with them in your judgment?
>
> The Witness: Well, the contract involved investment supervisory services, and I believe that is what is implicit in that in connection with the needs of each client, yes, sir.
>
> The Court: You thought that you were going into a trusteeship with them?

(footnote continued on following page)

Chase, Inc. did not misrepresent its business, methods or services to the plaintiffs.[20] In light of all the facts and circumstances in the present case, Chase, Inc. complied with its obligations, both statutory and contractual as bargained for by Anderson, with a proper degree of care and attention. Chase, Inc. provided "investment supervisory services" based upon the individual needs of each of the accounts insofar as those needs were predetermined by Anderson and represented by him to Chase, Inc. There is no factual basis in the evidence which the Court credits to substantiate the charge that Chase, Inc.'s procedures and systems were deficient and rendered it incapable of providing investment supervisory services. Chase, Inc. dealt fairly and frankly with plaintiffs and exercised sincere judgment with respect to plaintiffs' accounts. To the extent, if any, that the recommendations given to Anderson were erroneous marketwise, they nonetheless are found to have been given in good faith in the exercise of reasonable judgment. Hindsight is admittedly superior to foresight (as Anderson

(footnote continued from preceding page)

> The Witness: Fiduciary relationship, yes, sir.
>
> The Court: Well, fiduciary relationship is a word that covers many layers of meanings, but what you are describing is that they should have restrained you in some physical way so you couldn't issue orders to the traders to do the things that you did do. Now, I want to know what capacity or power they had to do that under the arrangements between you and your mother.
>
> The Witness: Well, they had a trading authorization from both of us.
>
> The Court: Which they never exercised, isn't that right?
>
> The Witness: That is to the best of my knowledge, but they had the authorization.

[20] Although some of plaintiffs' charges against Chase, Inc. may not have been individually discussed in Section II, each has been separately considered and found not to have been proved by a preponderance of the credible evidence.

has cause to recall in having sold short in rising markets) but that is not the test on which to judge the conduct of an adviser.

The services of Chase, Inc. under the agreement made by the parties were largely ignored and frustrated in material degree by Anderson acting in deliberate contravention of their understanding. The injuries suffered by plaintiffs in their stock transactions during the period of the relationship with Chase, Inc. and thereafter were caused solely by Anderson's conduct of the plaintiffs' affairs and were not contributed to improperly in any degree by the defendant.

The complaint is accordingly dismissed on all counts, with costs. The foregoing shall constitute the findings of fact and conclusions of law required by Rule 52(a), Fed. R. Civ. P.

So ordered.

Milton Pollack
District Judge

March 12, 1975

Appendix B, Judgment, United States District Court, Southern District of New York.

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

73 Civil 2530 (MP)

JUDGMENT

THE ANDERSON COMPANY and ALICE SCRANTON EASTMAN ANDERSON,

Plaintiffs,

—against—

JOHN P. CHASE, INC.,

Defendant.

The issues in the above entitled action having been brought on regularly for trial before the Honorable Milton Polack (*sic*), United States District Judge, on November 11, 12 and 13, 1974, and at the conclusion of the evidence the Court having reserved decision, and the Court thereafter on March 12, 1975, having handed down its opinion constituting its findings of fact and conclusions of law, in favor of the defendant, it is,

ORDERED, ADJUDGED and DECREED: That defendant JOHN P. CHASE, INC., have judgment against plaintiffs THE ANDERSON COMPANY and ALICE SCRANTON EASTMAN ANDERSON, dismissing the complaint on all counts, with costs to be taxed.

Dated: New York, N. Y.
March 14, 1975

SIGMUND F. BURGHARDT
Clerk

Appendix C, Judgment of Affirmance, United States Court of Appeals for the Second Circuit.

UNITED STATES COURT OF APPEALS

FOR THE

SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the eighteenth day of November one thousand nine hundred and seventy-five.

Present:

HONORABLE WILFRED FEINBERG
HONORABLE MURRAY I. GURFEIN
HONORABLE ELLSWORTH A. VAN GRAAFEILAND,
Circuit Judges,

No. 75-7239

THE ANDERSON COMPANY and ALICE SCRANTON EASTMAN ANDERSON,

Plaintiffs-Appellants,

—against—

JOHN P. CHASE, INC.,

Defendant-Appellee.

Appeal from the United States District Court for the Southern District of New York.

Appendix C, Judgment of Affirmance, United States Court of Appeals for the Second Circuit.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is affirmed on the opinions of Judge Pollack, dated March 12, 1975 and June 2, 1975.

Wilfred Feinberg

Murray I. Gurfein

Ellsworth A. Van Graafeiland
U.S.C.J.J.

Appendix D, Memorandum Decision.

THE ANDERSON COMPANY and ALICE SCRANTON EASTMAN ANDERSON *v.* JOHN P. CHASE, INC.
73 Civ. 2530(MP)

Motion denied. The section of the Inches deposition proffered on the present motion, taken as a whole and considered in light of the record at trial, would not have a material bearing, either with respect to the Court's resolution of the credibility questions or with respect to the findings of fact and conclusions of law previously entered. The December 11, 1973 deposition is plainly not newly discovered evidence. Nor may counsel's failure to introduce the proffered section at trial be deemed excusable. There was ample opportunity to do so, particularly at the close of trial when counsel in fact introduced other sections of the same deposition.

SO ORDERED.

June 2, 1975

MILTON POLLACK
U.S. District Judge

Appendix E, Investment Advisers Act Sections.

SUBCHAPTER II.—INVESTMENT ADVISERS

§ 80b—1. Findings

Upon the basis of facts disclosed by the record and report of the Securities and Exchange Commission made pursuant to section 79z—4 of this title, and facts otherwise disclosed and ascertained, it is found that investment advisers are of national concern, in that, among other things—

(1) their advice, counsel, publications, writings, analyses, and reports are furnished and distributed, and their contracts, subscription agreements, and other arrangements with clients are negotiated and performed, by the use of the mails and means and instrumentalities of interstate commerce;

(2) their advice, counsel, publications, writings, analyses, and reports customarily relate to the purchase and sale of securities traded on national securities exchanges and in interstate over-the-counter markets, securities issued by companies engaged in business in interstate commerce, and securities issued by national banks and member banks of the Federal Reserve System; and

(3) the foregoing transactions occur in such volume as substantially to affect interstate commerce, national securities exchanges, and other securities markets, the national banking system and the national economy.

Aug. 22, 1940, c. 686, Title II § 201, 54 Stat. 847.

§ 80b—2. Definitions

(a) When used in this subchapter, unless the context otherwise requires—

(13) "Investment supervisory services" means the giving of continuous advice as to the investment of funds on the basis of the individual needs of each client.

§ 80b—4. Reports by investment advisers

Every investment adviser who makes use of the mails or of any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser (other than one specifically exempted from registration pursuant to section 80b—3(b) of this title), shall make, keep, and preserve for such periods, such accounts, correspondence, memorandums, papers, books, and other records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memorandums, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors.

Aug. 22, 1940, c. 686, Title II, § 205, 54 Stat. 852; Sept. 13, 1960, Pub. L. 86-750 § 6, 74 Stat. 886.

§ 80b—6. Prohibited transactions by investment advisers

It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

(3) acting as principal for his own account, knowingly to sell any security to or purchase any security from a client, or acting as broker for a person other than such client, knowingly to effect any sale or purchase of any security for the account of such client, without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction. The prohibitions of this paragraph shall not apply to any transaction with a customer of a broker or dealer if such broker or dealer is not acting as an investment adviser in relation to such transaction;

(4) to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative. The Commission shall, for the purposes of this paragraph (4) by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.

Aug. 22, 1940, c. 686, Title II, § 206, 54 Stat. 852; Sept. 13, 1960, Pub.L. 86-750, §§ 8, 9, 74 Stat. 887.

§ 80b—6a. Exemptions

The Commission, by rules and regulations, upon its own motion, or by order upon application, may conditinoally or unconditionally exempt any person or transaction, or any class or classes of persons, or transactions, from any provision or provisions of this subchapter or of any rule or regulation thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this subchapter.

Aug. 22, 1940, c. 686, Title II, § 206A, as added Dec. 14, 1970, Pub.L. 91-547 § 26, 84 Stat. 1433.

§ 80b—8. General prohibitions

(a) It shall be unlawful for any person registered under Section 80b-3 of this title to represent or imply in any manner whatsoever that such person has been sponsored, recommended or approved, or that his abilities or qualifications have in any respect been passed upon by the United States or any agency or any officer thereof.

(b) No provision of subsection (a) of this section shall be construed to prohibit a statement that a person is registered under this subchapter or under the Securities Exchange Act of 1934, if such statement is true in fact and if the effect of such registration is not misrepresented.

(c) It shall be unlawful for any person registered under section 80b-3 of this title to represent that he is an investment counsel or to use the name "investment counsel" as descriptive of his business unless (1) his or its principal business consists of acting as investment adviser, and (2) a substantial part of his or its business consists of rendering investment supervisory services.

(d) It shall be unlawful for any person indirectly, or through or by any other person to do any act or thing which it would be unlawful for such person to do directly under the provisions of this subchapter or any rule or regulation thereunder.

Aug. 22, 1940, c. 686, Title II, § 208, 54 Stat. 853; Sept. 13, 1960, Pub. L. 86-750, §§ 10, 11, 74 Stat. 887.

§ 80b—14. Jurisdiction of offenses and suits

The district courts of the United States and the United States courts of any Territory or other place subject to the

jurisdiction of the United States shall have jurisdiction of violations of this subchapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity to enjoin any violation of this subchapter or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enjoin any violation of this subchapter or rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28, and section 7, as amended, of the Act entitled "An Act to establish a court of appeals for the District of Columbia", approved February 9, 1893. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against the Commission in any court.
Aug. 22, 1940, c. 686, Title II, § 214, 54 Stat. 856.

§ 80b—15. Validity of contracts

(a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this subchapter or with any rule, regulation, or order thereunder shall be void.

(b) Every contract made in violation of any provision of this subchapter and every contract heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of any provision of this subchapter, or any rule, regulation, or order thereunder, shall be void (1) as regards the rights of any person who, in violation of any such pro-

vision, rule, regulation, or order, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision.

Aug. 22, 1940, c. 686, Title, § 215, 54 Stat. 856.

Appendix F, Investment Advisers Act Regulation.

Reg. § 275.204-2. (a) Every investment adviser who makes use of the mails or of any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser (other than one specifically exempted from registration pursuant to Section 203(b) of the Act) shall make and keep true, accurate and current the following books and records relating to his investment advisory business:

* * *

(3) A memorandum of each order given by the investment adviser for the purchase or sale of any security, of any instruction received by the investment adviser from the client concerning the purchase, sale, receipt or delivery of a particular security, and of any modification or cancellation of any such order or instruction. Such memoranda shall show the terms and conditions of the order, instruction, modification or cancellation; shall identify the person connected with the investment adviser who recommended the transaction to the client and the person who placed such order; and shall show the account for which entered, the date of entry, and the bank, broker or dealer by or through whom executed where appropriate. Orders entered pursuant to the exercise of discretionary power shall be so designated.

* * *

(7) Originals of all written communications received and copies of all written communications sent by such investment adviser relating to (A) any recommendation made or proposed to be made and any advice given or proposed to be given, (B) any receipt, disbursement or delivery of funds or securities, or (C) the placing or execution of any order to purchase or sell any security; *provided, however,* (i) that the investment adviser shall not be required to keep any unsolicited market letters and other similar communications of general public distribution not prepared by or for the investment adviser, and (ii) that if the investment adviser sends any notice, circular or other advertisement offering any report, analysis, publication or other investment advisory service to more than 10 persons, the investment adviser shall not be required to keep a record of the names and addresses of the persons to whom it was sent; except that if such notice, circular or advertisement is distributed to persons named on any list, the investment adviser shall retain with the copy of such notice, circular or advertisement a memorandum describing the list and the source thereof.

* * *

(10) All written agreements (or copies thereof) entered into by the investment adviser with any client or otherwise relating to the business of such investment adviser as such.